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SUBJECT: APPARENT BREAKTHROUGH ON HYDROCARBON LAW AT
NOVEMBER 23-26 ENERGY COMMITTEE RETREAT - AGREEMENT IN SIGHT

REF: A. BAGHDAD 04350

- [1B.](#) BAGHDAD 04342
- [1C.](#) BAGHDAD 04351
- [1D.](#) BAGHDAD 03257

Classified By: Ambassador Zalmay Khalilzad for Reasons 1.4 (b) and (d).

11. (S) Summary. Apparent breakthroughs on the issues of contracting, arbitration and arrangements for revenue sharing have raised a real prospect that agreement on a hydrocarbon law can be reached in time for a draft to be submitted to the Council of Representatives (CoR) before it adjourns for two months in early January. The outlines of the deal show that significant movement was made by both the Kurdistan Regional Government (KRG) and central government sides, with the backdrop of high-level security discussions at the Policy Council for National Security (PCNS) meetings making it possible for negotiators to keep in touch with the political level during key phases of the talks. Nevertheless, the tentative agreement still needs to be blessed by senior Kurdish leadership and political party leaders. Many nettlesome drafting issues, especially regarding arrangements for regional sub-accounts within a national trust account under a revenue sharing plan remain to be worked out. The bottom line, however, is that an approach has been found that resolves several issues of principle and constitutional rights that had been stumbling blocks as recently as a week ago. With a final lobbying push and some goodwill on both sides, a draft law could well be debated in the CoR before the end of the year, marking a significant demonstration of Iraqis' ability to resolve major differences for the common good. End Summary.

Main Points

12. (S) Perhaps the main breakthrough made after the second Energy Committee retreat in Baghdad on November 23-24 is that the central government has accepted that contracts can be negotiated and signed by regional entities (reftel A). In exchange, a newly-created Federal Petroleum Committee (FPC) would retain reviewing authority of such contracts, preserving federal control of a nationally-shared resource (reftel B). The Kurds have built in a non-political vehicle for resolving any disputes between the central government and the regions (details below). The other significant breakthrough was that the central government has agreed to the establishment of regional sub-accounts within a national trust account which can be held offshore that would guarantee provincial or regional access to their share of revenues. In "exchange" the Kurds agreed to have such accounts nominally under the Central Bank of Iraq's administration. There was also agreement on the pillars of the hydrocarbon regime, including a re-established Iraq National Oil Company, along with regional operating companies and spin-off companies

transitioning from the existing Ministry of Oil (MinOil) to operate the export port and manage the pipeline system. Details on this restructuring remain to be clarified. To an outside observer, the regime that would be established may retain more elements of a centralized system than might be economically optimal, but there is enough competition built into the system that revenue maximization of the shared national resource is still an achievable objective. The proposed system should allow Iraq to develop its vast resources effectively and open the door to needed foreign investment within a year.

Accomplishments and Work Remaining

13. (S) Following significant progress on November 25, Energy Committee drafters (principally Government of Iraq energy advisor Thamir Ghadban and KRG Minister of Natural Resources Ashti Hawrami from Baghdad and Erbil respectively) met November 26 to put into writing what had been agreed across the table the previous day. One key outcome on the 25th had been to agree that a board of experts be appointed by the FPC to arbitrate any disagreements on deals negotiated and signed at the regional level but reviewed at the federal level. This arrangement replaces the transitional external arbitration arrangement that had been proposed earlier in the weekend, and is a significant step towards ensuring transparency on oil and gas contracting in Iraq. The members of the board are to be appointed unanimously on an annually-renewable basis, and are to have internationally recognized expertise in the field. The Kurds consider this arrangement their best guarantee that their regional constitutional rights will be respected, but have also built in a provision for the FPC to take decisions on contracts by a two-thirds majority. This provision will not provide the

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Kurds with a blocking share on their own, but they are content with this combination arrangement.

14. (S) Another key element the Kurds have introduced is a requirement for there to be tenders for international development of existing major fields, such as Rumaila, within two years of the law's adoption. That way, the Kurds believe, there will be more public transparency on what national hydrocarbon potential is, so that the central government does not "sit" on resources, as the Kurds assert the Iranian government does. A recurring theme in the talks was Kurdish fear that the central government would follow a course of inaction, and that their region would be tied to policy-making which was driven by non-economic factors. The Kurds intend to let out blocks of their territory for exploration within the next two years as well, the goal being again to get as good a picture of what total production potential in the Kurdistan Region is, and to encourage competition among smaller companies to develop these resources. In addition, an annex of projects to be developed on a priority basis is to be appended to the draft law to reassure the Kurds that they will get their share of infrastructure spending on refineries and pipelines.

Revenue

15. (S) Agreement was relatively easily reached on revenue sharing, which entails costing out services the central government provides to the regions) which are in practice often not delivered. In separate discussions with Kurdish negotiators, they complained that the '06 budget provisions had already resulted in reductions in their allocated 17 percent of national budget revenues, so they were keen to get iron-clad guarantees that would give them the greatest possible access to their sub-accounts in cash. This part of the crafting of the draft law will likely prove to be the most difficult, since the negotiators on both sides acknowledge they are not financial experts. Embassy has

offered to provide additional advice in this area.

Atmospherics

¶6. (S) There were tense moments in the negotiations, mostly centering on the Kurds' assertion that they could not be expected to have any faith in the goodwill of the central government. They were also skeptical that the government would not fall into the hands of religious extremists or Arab chauvinists who would work counter to Kurdish interests.

Such assertions were particularly problematic for Minister of Oil Shahristani (reftel C), and it is worth noting that many of the breakthrough decisions were reached on the final day of the committee meeting, which he did not attend.

Nevertheless, with an embassy officer present, it was striking that the talks were conducted in a spirit of finding a compromise, despite misgivings which had been expressed to us on the eve of the talks by both Ashti and Ghadban. Much of the success of the talks can probably be credited to Energy Committee Chair and Deputy Prime Minister (DPM) Barham Salih, who hosted the sessions, and who alternately represented central government interests and Kurdish concerns masterfully (reftel D). When Ashti threatened to halt the talks if issues of principle (contracting) were not resolved first, Barham insisted on proceeding on areas of agreement, like the scope for regional operating companies, as a way to keep the momentum going. All in all, the talks reflected the ability of the ministers and negotiators to find common ground, which will, it is hoped, extend to the round of getting the political seal of approval shortly. An indication that it is not over till it's over, however, was that on November 26, Barham noted that Sunni elements of the government were objecting to parts of the deal.

¶7. (S) The rest of the coming week will be taken up with further drafting, hampered somewhat by the fact that Ghadban is also acting as an economic adviser to the Prime Minister and thus has less time to focus on hydrocarbon drafting. The trade off is that his access to the PM should help obtain Maliki's endorsement of the compromises reached. The Kurdish side does not wish any public announcements of a breakthrough made until endorsement by both sides has been obtained. Our goal over the next days is to speed up that process as much as possible. In the meantime, Embassy is making its technical/legal expertise available to the negotiators to make as much progress as possible on the text.

KHALILZAD